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IN THE

Supreme Court of the United States

October Term, 1972.

No. 72-1657.

F. H. McGRAW AND COMPANY, Bankrupt,
Petitioner,

v.

FELLOWS CORPORATION, Formerly Known as the FELLOWS GEAR SHAPER COMPANY,
Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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JURISDICTION.

Petitioner invokes the jurisdiction of this Court under 11 USC 47(c) and 12 USC 1254(1). It is respectfully submitted that there is no jurisdiction in this Court under 12 USC 1254(1) since it appears that no such statutory provision presently exists. It is presumed that the jurisdiction of this Court is also invoked under 28 USC 1254(1).

QUESTIONS PRESENTED.

1. May a Court of Appeals set aside findings of fact of a referee in bankruptcy which have been affirmed by the District Court where there is a firm conviction on the part of the Court of Appeals, based upon all the evidence, that a mistake has been made?

2. May a Court of Appeals set aside the legal conclusions of a referee in bankruptcy which have been affirmed by the District Court, without regard for the "clearly erroneous" test?

3. Will the decision of the Court of Appeals, setting aside the findings of the referee in bankruptcy in the instant case, likely result in unnecessary and unwarranted appeals in this circuit unless corrected?

SUPPLEMENTAL STATEMENT OF THE CASE.

Petitioner has omitted certain relevant facts from its Statement of the Case which are needed for a determination concerning the issuance of a Writ of Certiorari. Reference is made to the following:

1. At the time of the filing of its Chapter XI Petition, F. H. McGraw and Company (hereinafter "McGraw" or "Debtor") was general contractor for the construction of a multi-million dollar manufacturing plant in Springfield, Vermont for the Fellows Corporation (hereinafter "Fellows" or "Claimant").

2. Counsel for Fellows, realizing that his client must immediately take over the responsibility for paying materialmen and subcontractors in order to keep them from leaving the job, entered into correspondence and telephone conversations with counsel for the Receiver appointed for Debtor in order to protect Fellows against the possibility of the Receiver's later contending that such payments should have been made directly to him.

3. After the Receiver obtained the consent of Debtor for Fellows to assume responsibility for such payments, counsel for the Receiver suggested that the parties utilize a petition and order form similar to that previously entered into between the Receiver and another corporation. After examination of the proposed form, counsel for Fellows consented to its use and authorized the Receiver to proceed. Subsequently, the Receiver presented the petition and order to the Honorable Thomas J. Curtin, Referee of the Bankruptcy Court.

4. At no time during the above-mentioned discussions between respective counsel was there ever any mention regarding waiver by Fellows of any claim that it might ultimately have against the Debtor for a deficiency if the cost of completion of the project exceeded the original contract price. However, the order as submitted to the Referee and approved by him, contained the following paragraph (not contained in the model order agreed to by Fellows), the interpretation of which is the subject of the instant litigation:

> And It Is Further Ordered and Decreed that Philip F. Newman, Receiver herein, shall not be liable for any claim for deficiency if the costs of completion of the contract exceed the balance of the contract price.

5. Upon receiving and reviewing a copy of the signed Order, counsel for Fellows interpreted the new language as merely barring Fellows from holding the receiver personally liable for any claim for the costs of administration. Based upon this interpretation, counsel for Fellows made no objection to the language. There was no subsequent communication between counsel regarding the language.

REASONS FOR REFUSING THE WRIT.

I. The Decision Below Is Correct.

In the court below the Petitioner argued that there was a reasonable basis on the record to support the findings of the Referee that (1) Fellows had agreed to release any claim for deficiency under the building contract in exchange for various waivers on the part of the Receiver concerning the Debtor's right to complete the contract and (2) Fellows, with full knowledge of the release provision in the Referee's Order, had accepted the benefit of the Receiver's waivers, authorized by the same Order, and thereby implicitly assented to the release. These findings were affirmed by the District Court.

Upon review, the Court of Appeals held that there was no evidence to support the finding that the parties had bargained for the release of all claims by Fellows against the Debtor and further, that since the release language was ambiguous such ambiguity should have been construed most strongly against the party drafting the provision—namely, the Receiver.

Petitioner now contends that the Court of Appeals erred in that it ignored the so-called "clearly erroneous" rule in its review of the Referee's findings, deciding the basic issues of fact in the case as if it were before the court de novo (Pet. 10). Thus, the primary issue which Petitioner asks this Court to determine is the proper scope of review of a referee's findings of fact, and by implication, his conclusions of law.

A close review of the evidence presented to the Referee at the hearing on the objection to the claim of Fellows and an analysis of the reasoning of the majority of the court below indicates that the Court of Appeals acted well within the permissible limits of its review power in the instant case, both with regard to the findings of fact and the conclusions of law of the Referee.

A. A Court of Appeals May Set Aside the Basic Findings of Fact of a Referee Where, as in the Instant Case, Based Upon an Evaluation of the Complete Record Below, It Is Left With the Firm Conviction That a Mistake Has Been Committed.

The Referee based his dismissal of Claimant's Proof of Claim largely upon contractual principles, finding that Fellows had contractually released the Debtor. As his sixth finding of fact indicates,[1] the Referee apparently determined that an agreement had been reached between the parties prior to the filing of the Petition and Order by which Fellows specifically agreed to release the Debtor from future claims for deficiency if the costs of completion of the building contract exceeded the balance of the contract price.

In order to lead to the legal conclusion that a contract for release was entered into by the parties, the transactions between respective counsel prior to the filing of the Order would necessarily have to contain the primary contractual elements of offer and acceptance. In short, the evidence would have to demonstrate both that the Debtor agreed to permit Fellows to assume responsibility for paying the materialmen and subcontractors in return for an agreement by Fellows to release Debtor from all possible claims for deficiency, and that Fellows accepted this offer.

In fact, the record before the Referee is devoid of any evidence that the subject of the release was ever discussed by either party prior to submission of the Order to the Referee. Moreover, the testimony of both counsel who testified, when taken together, establishes that the specific

1. The Referee's sixth finding of fact reads as follows:

6. The Receiver agreed to file said petition upon the consideration that the Debtor would not be liable for any deficit with respect to the completion of said contract and that the Debtor would benefit to the extent that profit resulted therefrom. (A 22)

language upon which the litigation is focused was unilaterally inserted into the Order by counsel for the Receiver without the prior knowledge of counsel for Fellows, who first became aware of the language when he received a certified copy of the Order after it had been signed by the Referee.

Significantly, the record is also devoid of any facts from which such an agreement between the parties could reasonably be implied. And without such agreement between the parties there was no factual basis for the Referee's legal construction of the admittedly ambiguous language of his Order. Thus, as the Court of Appeals Opinion stated:

> Under the circumstances herein presented—where there is no evidence of prior discussion between Fellows and the receiver as to the inclusion of this language, let alone the drastic consequences flowing therefrom now urged upon this court—we are unwilling to attribute to this language the full force and effect of a bar to claims not matured or accrued at the time of the writing. 473 F. 2d at 468.

In setting aside the Referee's finding that the parties had contracted for the release, the Court of Appeals was exercising the appellate jurisdiction provided for by Section 24 of the Bankruptcy Act, as amended, 11 USC § 47, which provides in pertinent part:

> § 47 *Jurisdiction of appellate courts* (a) The United States courts of appeals, in vacation, in chambers, and during their respective terms, as now or as they may be hereafter held, are invested with appellate jurisdiction from the several courts of bankruptcy in their respective jurisdictions in proceedings in bankruptcy,

either interlocutory or final, and *in controversies arising in proceedings in bankruptcy, to review, affirm, revise, or reverse, both in matters of law and in matters of fact.* (emphasis added)

As Petitioner properly points out, the authority to review outlined in 11 USC §47 is somewhat limited by General Order in Bankruptcy No. 47 which has been adopted by this Court and provides that findings of fact should normally not be set aside by a reviewing court unless "clearly erroneous."[2]

It is well-established however, that the "clearly erroneous" rule does not constitute a blanket prohibition on the Court of Appeals' inherent power to modify or set aside a referee's findings of fact. On the contrary, it has long been the rule of this Court that even when there is evidence to support a finding of fact, such finding may be set aside when, on the entire evidence, the reviewing court is left with the definite and firm conviction that a mistake has been committed. *United States v. United States Gypsum Co.*, 333 U. S. 364 (1948).

Analysed in the light of the rule in *Gypsum* the Referee's finding that the parties had agreed to a release by Fellows, based as it was, upon no firm evidence of record, constituted precisely that kind of blatant, serious mistake which the Court of Appeals is empowered to correct.

The Referee committed equally serious mistakes in his evaluation of the failure of counsel for Fellows to make timely objection to the disputed language upon receipt of the Order, and in the inferences drawn therefrom. The

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2. 11 USC following Section 53, and implemented by Rule 52(a) of the Federal Rules of Civil Procedure, 28 USC 52.

Referee's twelfth and thirteenth findings of fact[3] make it abundantly clear that he considered the fact that counsel for Fellows received, read and failed to object to the Order, to be significant. Indeed, these facts were presumably the basis upon which he arrived at the following conclusion of law:

> 6. Fellows sought neither review nor modification of the order within ten days as required by Section 39 of the Bankruptcy Act and accordingly is bound thereby. (A 25)

It is also apparent that the Referee implied a contract of release after the fact, from the failure to act on the part of counsel for Fellows. In so finding, the Referee neglected the only evidence of record which bore generally on the intention of the parties and specifically on the reason for counsel's failure to file an objection.

In this regard, counsel for Fellows specifically testified that he had understood the release language to do nothing more than relieve the Receiver from personal liability for the costs of administration. While this interpretation may not have been a technically acceptable interpretation, given the intricacies of bankruptcy procedure, the testimony was uncontroverted and represented the only evidence on the record regarding the intention of either of the parties. In this regard, the testimony is doubly

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3. The Referee's twelfth and thirteenth findings of fact read as follows:

> 12. Fellows by its counsel received and read a certified copy of the petition and order promptly after its entry on January 21, 1969 (N. T. pp. 30 and 43).
>
> 13. Fellows made no objection in respect of the order or petition, either formally or informally, and did not communicate with the Referee, the Receiver or the Receiver's Counsel with respect to the terms of the petition or order (N. T. p. 47). (A 23)

significant since it clearly establishes that Fellows never intended to waive its potential claims against Debtor; and it also clearly explains why counsel for Fellows failed to act upon receipt of the Order.

That the Referee failed to consider the "interpretation" offered by counsel for Fellows is readily apparent from the record of the hearing. As Judge Aldisert pointed out in footnote 1 to the Opinion of the Court:

> 1. The referee ruled that 'the plain meaning of the release' relieved the receiver of liability. In so ruling the referee made it clear that he was interpreting his own order without reference to the intention or expectancies of the parties. Counsel for Fellows was asked what the provision meant to him when he read the order. After questioning the relevance of counsel's interpretation, the referee admitted the interpretation with the observation: 'It doesn't make that much difference, I still have the determination. . . .' Although counsel for the receiver objected late to the admission of the interpretation placed upon the order by counsel for Fellows as irrelevant, the referee permitted the witness to continue, saying, 'It is the same principal. I am still going to make the determination, not the witness.' This colloquy indicates that although the interpretation of Fellows' counsel was received as evidence, it was not considered by the referee in his interpretation of the order and thus '[i]t is the same' as excluding the interpretation. 473 F. 2d at 466.

In refusing to consider the testimony of counsel for Fellows, the Referee discarded the most important, if not the only, evidence on the question of the intention of the parties. As the Court of Appeals noted, the determination of the intent of the parties is particularly critical in

the instant case since the language in question is ambiguous. Due to the nature of the evidence, the Referee's omission necessarily affected virtually all of his legal conclusions. This blatant mistake also justifies the action of the Court of Appeals.

B. The Court of Appeals Has the Inherent Power to Set Aside or Modify the Legal Conclusions of a Referee in Bankruptcy, Without Regard to the "Clearly Erroneous" Rule.

Although Petitioner expresses some doubt as to whether the language which is the subject of this litigation is ambiguous, there can be little question that the language, on its face, leaves a good deal of room for more than one interpretation. As pointed out in the Opinion of the Court of Appeals, reference is uniformly made to "McGraw" in each of the provisions of the Referee's Order which had been agreed to by respective counsel prior to its signing. Thus, the Receiver was empowered to "Authorize . . . payment . . . to McGraw . . . employees;" to "Authorize direct payments . . . to all subcontractors and material suppliers of McGraw;" to "Authorize assignment by McGraw . . .;" and to "Authorize . . . waiver[s] by McGraw," etc. By contrast, in that portion of the Order which is in dispute, the name "McGraw" is not used; instead, the Order states that "Philip F. Newman, Receiver herein, shall not be liable" for the cost of completion should that cost exceed the contract price.

Regardless of whether the failure to mention the Debtor's name in the disputed sentence was accidental, a very definite ambiguity was created, which, as the Court of Appeals points out, must be interpreted most strongly against the party who drafted it. Following this approach, Judge Aldisert analysed the provision as follows:

> We find such an ambiguity. The language has the capacity of being interpreted as releasing the named receiver, and thereafter a trustee, from accepting any claim as a debt having priority as "actual and necessary costs and expenses of preserving the estate subsequent to filing the petition." 11 USC § 104(a)(1). *In re Connecticut Motor Lines, Inc.*, 336 F. 2d 96 (3d Cir. 1964). 473 F. 2d at 468.

The Referee's third conclusion of law suggests that he too may have recognized an ambiguity in the disputed language:

> 3. Where the terms of a judicial order are susceptible of more than one interpretation, the Court should adopt that interpretation which appears most reasonable under the circumstances at the time of entry of the order. (A 24)

However, it is evident that he failed to follow any recognized principles of contract interpretation in resolving that ambiguity. On the one hand, there is absolutely no indication that he construed the ambiguity against the party drafting the language (in this case the Receiver), which is the generally accepted course, given such ambiguity. WILLISTON, SELECTIONS ON CONTRACTS, Student Edition, § 621; RESTATEMENT, CONTRACTS § 236. Moreover, in arriving at his interpretation, the Referee apparently chose to fully disregard a basic rule of construction approved by Pennsylvania courts which mandates the strict construction of general language in a release, particularly when such language could have the effect of barring the enforcement of future, unaccrued claims. *Davis v. United States Gypsum Co.*, 451 F. 2d 659 (3d Cir. 1971); *Neville Chemical Co. v. Union Carbide Corp.*, 422 F. 2d 1205 (3d Cir. 1970); *Restifo v. McDonald*, 426 Pa. 5, 230 A. 2d 199 (1967).

Rather than follow such recognized principles, the Referee held that the language in a judicial order should be given its "plain meaning." In arriving at this meaning the Referee chose the "most reasonable" interpretation of the language, given the circumstances at the time of entry of the Order. Thus, reasoning that under principles of bankruptcy law the Receiver would have no personal liability or cost of administration liability to Fellows with respect to any default by Debtor or with respect to any deficiency if the cost of completing the contract exceeded the contract price, the Referee found that there could be only one reasonable interpretation—namely, that the language effectuated a release of Fellow's potential claim against the Debtor's estate (A 24).

In refusing to permit the Referee's conclusions of law regarding the meaning of the disputed language to stand, Judge Aldisert made it clear that the Court of Appeals was not establishing new rules of construction, but rather was enforcing those presently in existence:

> This is not to suggest, however, that where there is specific, as distinguished from general, language, in an instrument, or under circumstances where the intent of parties is clearly demonstrated, that we would not give full force and effect to a release which operates as an absolute bar to recovery. We hold merely that under the circumstances presented to the referee, he should have found the language to be ambiguous. And, recognizing the principle that ambiguous language will be resolved against the author thereof, and mindful of the desireability of strict construction of a release from claims not yet accrued or matured, the referee should have allowed Fellows' claim as a general, unsecured creditor. 473 F. 2d at 469.

It is by now well-established that the same presumption of correctness which is afforded the findings of fact of a referee, is not extended to his conclusions of law. *Walker v. Commercial National Bank of Little Rock,* 217 F. 2d 677 (8th Cir. 1954); *In re Madway,* 179 F. Supp. 400 (E. D. Pa. 1959); *In re Newcomb Interests, Inc.,* 171 F. Supp. 704 (N. D. Cal. 1959). Consequently, while the legal conclusions of a referee will be treated with respect, a reviewing court is permitted to make wholly independent determinations on questions of law. The failure of the Referee in the instant case to apply the proper legal standards in the interpretation of the language at issue is a legal error which pervades the entirety of the Referee's conclusions of law and which thoroughly justifies the action taken by the Court of Appeals.

II. Neither Uncertainty Nor Unnecessary and Unwarranted Appeals on Questions of Fact Will Result From the Decision of the Court of Appeals.

The Decision Below in the Instant Case Is Not in Conflict With Prior Decisions of the Court of Appeals for the Third Circuit.

Petitioner suggests that a Writ of Certiorari should be granted in the instant case to prevent uncertainty and the possibility of a "veritable avalanche" of appeals on questions of fact in the Third Circuit. In support of this contention, Petitioner argues that the decision below is in direct conflict with prior decisions of the Court of Appeals for this circuit.

Assuming, *arguendo,* that Petitioner is correct in the assumption that the Court of Appeals liberally construed its power of review in setting aside the findings of fact of the Referee, the approach of the majority can hardly be viewed as novel or in conflict with prior authority in the

Third Circuit. More than 15 years ago, Judge Kalodner, speaking for the Court of Appeals for the Third Circuit stated in *In re Pioch*, 235 F. 2d 903 (3d Cir. 1956);

> Before proceeding further it must be pointed out that the District Court erred in its view that 'The Referee's conclusion that the bankrupt intended to hinder, delay, and defraud his creditors must be affirmed by this Court unless it is clearly erroneous.'
>
> With respect to the Referee's 'conclusion' it must immediately be noted that it was in the nature of an ultimate finding of fact and on that score, it is well settled that such a finding is but a legal inference from other facts and as such is subject to review free of the restraining impact of the so-called 'clearly erroneous rule' applicable to ordinary findings of fact by the trial court. 235 F. 2d at 905.

Like the findings of fact in the *Pioch* case, the Referee's findings in the instant case were largely based upon legal inferences drawn from evidence presented at the hearing. As such they were subject to review by the Court of Appeals without regard to the "clearly erroneous" rule, although, as previously discussed, it is Respondent's contention that they represented such gross mistakes that the Court of Appeals was justified in setting them aside in any event.

The approach taken by Judge Kalodner in *Pioch* has been alluded to with approval in a number of more recent decisions of the Court of Appeals for the Third Circuit and most notably in two opinions relied upon by Petitioner. *In re Steiker*, 380 F. 2d 765, 768 (3d Cir. 1967); *In re Arbycraft Co.*, 288 F. 2d 533, 556 (3d Cir. 1961).

There is no indication that an excessive number of unwarranted appeals on questions of fact have resulted

from the decision in the *Pioch* case and the more recent decisions which have reiterated the liberal rule articulated in *Pioch*. It is therefore respectfully submitted that Petitioner's stated concern over future such appeals is wholly unwarranted.

CONCLUSION.

For the reasons stated above, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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